Reorganisation measures for a financial group receiving state aid

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The economic and financial crisis beginning in 2007 led to the collapse of various derivative markets and the resulting crisis of confidence within the financial sector brought the interbank market to a standstill. Financial institutions ("Institutions") that until then had re-financed a considerable part of their total assets based on short-term borrowing, now threatened to set off a chain reaction in the event they became insolvent such that state aid was needed. In scenarios such as those, the European Commission ("Commission") must be notified before state aid is granted in order so that it may examine whether such aid is compatible with the European Single Market.

The Commission approved state aid to twelve of the twenty largest European Institutions from the beginning of the crisis through December 2014. In all, 112 Institutions holding approximately 30% of all assets in the European banking system needed support. In the end, the Commission issued 450 state aid decisions, inspected 56 reorganisation plans and agreed to the orderly liquidation of 33 banks.

Between the end of 2008 and mid-2009, the Commission published the Banking, Recapitalisation, Risk Assets and Restructuring Communications ("Crisis Communications") in order to guarantee the effective functionality of the financial markets and to provide specifics for addressing state aid. This article describes the implementation of the reorganisation plan of an institution that received an aid in 2009. When examining state aid, the Commission applies the rules in effect at the time it was granted. Therefore more up-to-date provisions (such as BRRD or the updated Banking Communication), which partly replace or amend the crisis communications, will not be considered here.

Member States that grant an institution state aid must fulfil the obligations that derive from EU state aid law, including the Crisis Communications, and from the respective national jurisdiction. This includes, inter alia, the requirement that either a liquidation or a reorganisation plan must be presented within six months of the recapitalisation for institutions that are fundamentally not healthy. The sample in the appendix to the Restructuring Communication provides an outline for the organisation of such a plan that must be implemented by the Institution receiving state aid within five years. It reflects the requirements for a grant of state aid - in this case measures to restore profitability or for orderly liquidation, respectively, or an appropriate contribution of own funds from the recipient, as well as compensatory measures to reduce competitive distortions. Figure 1 shows the elements of this sample plan.

<u>Content of a restructuring plan</u>

1. Information regarding the financial institution
2. Description of markets and markets shares
3. Analysis of the reasons for financial difficulties of the institution
4. Description of state support measures and evaluation of state aid
5. Return to profitability
6. Own contribution/ loss distribution
7. Measures to reduce competitive distortions
8. Monitoring

Source: European Commission, Restructuring Communication (2009)

Figure 1: Content of a restructuring plan

The advanced reorganisation of a European financial group ("Financial Group") will be used as a practical example of the operational measures taken to implement such a reorganisation plan. In accordance with the re-privatisation commission by the owner and the aid decisions issued by the Commission, all units on a central and local level were each separated into strategic and non-strategic units. As part of a three-pillar strategy, the financial group fundamentally restructured the banking group and repeatedly made recapitalisations. A banking subsidiary "Alpha" and a group of additional banking subsidiaries "Beta" were the first two pillars that had to be re-privatised during reorganisation in order to reduce market presence and total assets of the group. The third pillar, wind-down, includes all non-strategic assets that are liquidated in a manner that preserves equity and asset values. For this purpose, a central management holding company was carved out of the former parent company in 2014, furnished with a new bank licence, and the remaining part was transformed into the present deregulated wind-down unit.

According to the aid decision, the sale of individual units had to be accompanied by sales-promoting measures in order to reduce the risk. As such, regionally specific business and financing strategies were adjusted in "Beta", and selected loan portfolios of local banks were transferred to wind-down units in order to boost capital and financial ratios. Business strategies were adjusted with the focus on selected customer segments of each country, considering the conditions for new credit transactions. These commitments restrict business transactions with regard to return, customer risk categories and extension of credit to corporates or public authorities in order to minimise the possibilities of a business expansion to the detriment of competitors. The modified financing strategy aims to develop more local refinancing sources instead of group funds. Repeated adjustments were implemented as synthetic transfers, disposals, split(-offs) or contributions, depending on their composition.

Figure 2 provides an overview of selected measures within the reorganisation and liquidation plan of the financial group, which are monitored by a trustee.

The scope of the measures shown illustrates their complexity. It must be noted that essential components of the reorganisation and liquidation plan were achieved on schedule, for example the sale of the former banking subsidiary "Alpha", signing of the sales contracts about the shares of a group of further banking subsidiaries "Beta" with a simultaneous transformation or deregulation, respectively, of the parent company for the purpose of establishing the present wind-down unit, as well as the transfer of a third banking subsidiary "Gamma" to a special purpose vehicle newly established for this purpose by the respective Member State. The factors that in the end ensured successful operational implementation of transactions that were concluded in parallel for the first time, included close cooperation between bank committees and political stakeholders, the early involvement of all supervisory authorities concerned, as well as effective internal management of all necessary initiatives and projects as well as of the required resources.

Chapter	Measure	Implemented initiatives and projects (excerpt)
Restoration of profitability	Sale "Alpha"	Portfolio adjustment of a banking subsidiary "Alpha" by splitting-off a partial portfolio Carve-out by splitting-off a banking subsidiary "Alpha" from group holding company Sale of the banking subsidiary "Alpha"
	Sale "Beta"	Implementation of a central management holding company as operating model Separation of management holding company from group holding company (Repeated) portfolio adjustment in local institutions Sale of a group of banking subsidiaries "Beta"
	Wind-down unit	Examination of primary models based on a legal and economic evaluation Implementation of an operating model for local wind-down units to achieve operational separation of local banking units Deregulation of previous group holding company and transformation into central wind-down holding company Establishment of a special purpose vehicle for transfer of another subsidiary "Gamma"
Own contributions/ loss distribution		Operational transformation and disposal of non-performing assets Inclusion of former shareholders/owners for allocation of losses
Measures to reduce competitive distortions	General commitments	Pursuit of a cautious business policy, transfer of profits and own contributions Inclusion of former shareholders/owners for allocation of losses
	Behavioral commitments	Restrictions on new transactions in all business segments with regard to profit, customer rating, maturities, loans, etc

Figure 2: Selected measures implemented as part of the restructuring and liquidation plan

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